

General Information Letter: Subchapter S corporation shareholder whose adjusted gross income was increased by agreement with the IRS to include the audit increases in income of the corporation allocable to all shareholders must include such increase in his base income.

July 6, 2001

Dear:

This is in response to your letter dated June 28, 2001, in which you request a letter ruling. The nature of your request and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at www.revenue.state.il.us.

In your letter you have stated the following:

The Internal Revenue Service (IRS) has completed an examination of xxxxxx
xxxxxxxxxxxxxxxxxxxxxxxxxxxx 1998 Form 1120S which resulted in additional taxable income
of \$174,315 (Form 4605 attached). Based on the significant number of shareholders
(18) of xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx, the IRS and xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx
agreed to charge the entire increase in taxable income to one shareholder. They
agreed to use shareholder xxxxxxxxxxxxxxxxxxxxxxx 1998 Form 1040 to report the net
federal tax due based on the 1998 Form 1120S adjustments and each shareholders
share of income and their individual tax rates. None of the other shareholders will be
filing amended federal tax returns.

One of the adjustments made by the IRS changed the depreciable life on qualified
property placed in service in 1998 from 3 years to seven years. The property (cost of
\$122,711) is now eligible for the Illinois investment credit at the corporate level and the
enterprise zone investment credit at the shareholder level. The enterprise zone
investment credit to be "passed through" amounts to \$613.

Request

Due to the significant number of shareholders and the IRS decision to charge the
entire increase to one shareholder, it is request that the Illinois Department of Revenue
allow the entire increase in taxable income and enterprise zone investment credit be
included in the return of xxxxxxxxxxxxxxxxxxx. If this request is approved, none of the
other shareholders would be filing Illinois amended returns.

Response

Under Section 203(a) of the Illinois Income Tax Act (the "IITA"; 35 ILCS 5/101 *et seq.*), the
computation of an individual's base income begins with that individual's adjusted gross income as
properly reportable for federal income tax purposes. Section 403(b) of the IITA provides:

A final determination pursuant to the Internal Revenue Code adjusting any item or items of income, deduction or exclusion for any taxable year shall be correct for purposes of this Act to the extent such item or items enter into the determination of base income.

Pursuant to this provision, the decision of the Internal Revenue Service to increase the income of xxxxxxxxxxxxxxxx only, and not to adjust the incomes of any of the other shareholders, is deemed correct. Only xxxxxxxxxxxxxxxx base income is therefore increased as a result of the audit of xxxxxx xxxxxxxxxxxxxxxxxxxxxxxx.

Section 506(b) of the IITA requires taxpayers to file a report with the Illinois Department of Revenue whenever an alteration of an item of income or deduction is made for federal income tax purposes and the alteration affects base income. Because xxxxxxxxxxxxxxxx base income has been increased as a result of the Internal Revenue Service's determination, he must file a report under this provision. Because the other shareholders' base incomes are not affected by the audit, they have no obligation to report any change in base income.

Section 201(f) of the IITA, which provides for the enterprise zone credit, provides that:

For partners and for shareholders of Subchapter S corporations, there shall be allowed a credit under this subsection (f) to be determined in accordance with the determination of income and distributive share of income under Sections 702 and 704 and Subchapter S of the Internal Revenue Code.

There is no provision in Illinois law that would allow xxxxxxxxxxxxxxxx to claim the additional enterprise zone credit properly allocable to other shareholders of xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx under Subchapter S of the Internal Revenue Code. Accordingly, he may claim only his own share of any increase in the allowable credit and the other shareholders must file separate claims for their shares in any increase in the credit.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b). If you have any further questions, you may contact me at (217) 782-7055.

Sincerely,

Paul S. Caselton
Deputy General Counsel -- Income Tax